

AUDITED FINANCIAL STATEMENTS
St. Joseph Health Services of Rhode Island
Years Ended September 30, 2006 and 2005

St. Joseph Health Services of Rhode Island

Audited Financial Statements

Years Ended September 30, 2006 and 2005

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Report of Independent Auditors

Board of Trustees
St. Joseph Health Services of Rhode Island

We have audited the statements of financial position of St. Joseph Health Services of Rhode Island (the Corporation) as of September 30, 2006 and 2005, and the related statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Corporation's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of St. Joseph Health Services of Rhode Island at September 30, 2006 and 2005, and the results of its operations and changes in net assets, and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the accompanying consolidated financial statements, in 2006 the Corporation changed its method of accounting for asset retirement obligations.

Ernst & Young LLP

December 15, 2006

St. Joseph Health Services of Rhode Island

Statements of Financial Position

	September 30			September 30	
	2006	2005		2006	2005
Assets			Liabilities and net assets		
Current assets:			Current liabilities:		
Cash and cash equivalents	\$ 7,595,024	\$ 15,594,747	Accounts payable	\$ 8,401,879	\$ 7,362,522
Investments	23,281,956	18,418,085	Deferred revenue	196,327	226,638
Patient accounts receivable, less reserves of \$10,877,000 in 2006 and \$10,305,894 in 2005 for estimated uncollectible accounts	24,650,418	18,787,335	Accrued expenses	7,693,252	7,153,442
Other receivables	2,639,537	2,023,184	Estimated settlements due to third-party payors	23,334,424	21,307,162
Inventories	2,117,617	1,894,891	Current installments of long-term debt	435,000	410,000
Current portion of assets held by trustees under loan indenture	1,052,345	1,037,642	Current obligations under capital leases	1,651,864	618,006
Current portion of pledges receivable, net	102,504	138,301			
Prepaid expenses	1,386,477	915,882	Total current liabilities	41,712,746	37,077,770
Total current assets	62,825,878	58,810,067			
Assets whose use is limited:			Insurance reserves	2,756,594	2,638,437
Held by trustees under loan indenture	1,601,091	1,576,559	Pension liability	3,095,350	5,899,702
Beneficial interest in perpetual trust	5,826,358	5,727,510	Capital lease obligations	4,259,489	1,706,171
Held by trustee under workers' compensation program	844,121	340,292	Asset retirement obligation	2,732,346	—
Endowment funds	899,599	873,264	Long-term debt, excluding current installments	19,720,986	20,139,789
	9,171,169	8,517,625	Total liabilities	74,277,511	67,461,869
Long-term investments	626,188	752,512			
Property, plant and equipment, net	45,657,087	39,387,480	Net assets:		
Prepaid pension costs	—	410,650	Unrestricted	35,458,367	37,689,931
Intangible pension asset	—	5,080,161	Temporarily restricted	2,276,024	1,871,193
Pledges receivable, net	164,313	253,275	Permanently restricted	6,853,461	6,620,850
Deferred financing costs	420,728	432,073	Total net assets	44,587,852	46,181,974
Total assets	\$118,865,363	\$113,643,843	Total liabilities and net assets	\$118,865,363	\$113,643,843

See accompanying notes.

St. Joseph Health Services of Rhode Island

Statements of Operations and Changes in Net Assets

	Years Ended September 30	
	2006	2005
Unrestricted revenues, gains and other support:		
Net patient service revenue	\$ 167,221,274	\$ 156,680,953
Other operating revenue	10,448,396	9,985,400
Assets released from restriction	144,989	357,567
Total revenues, gains and other support	177,814,659	167,023,920
Operating expenses:		
Salaries and benefits	102,284,690	95,102,624
Supplies and services	55,167,682	52,259,904
Licensing fee	4,919,485	4,076,878
Interest	1,462,592	1,253,300
Depreciation and amortization	4,769,874	4,458,385
Provision for bad debts	9,760,662	8,740,574
Total operating expenses	178,364,985	165,891,665
(Deficiency) excess of revenues over expenses	(550,326)	1,132,255
Change in unrealized gains on investments	(27,171)	(38,845)
Adjustment to minimum pension liability	819,541	(819,541)
Net assets of H.E.L.P. Lead Safe Center assumed	(10,000)	236,082
Cumulative effect of change in accounting principle	(2,732,346)	—
Net assets released from restrictions used for purchase of property and equipment	268,738	873,454
(Decrease) increase in unrestricted net assets	(2,231,564)	1,383,405

St. Joseph Health Services of Rhode Island

Statements of Operations and Changes in Net Assets (continued)

	Years Ended September 30	
	2006	2005
Temporarily restricted net assets:		
Contributions	\$ 754,877	\$ 1,066,154
Change in unrealized gains on investments	63,681	56,113
Assets released from restriction	(413,727)	(1,231,021)
Increase (decrease) in temporarily restricted net assets	404,831	(108,754)
Permanently restricted net assets:		
Contributions	130,102	30,200
Change in unrealized gains on investments	102,509	330,604
Increase in permanently restricted net assets	232,611	360,804
(Decrease) increase in net assets	(1,594,122)	1,635,455
Net assets at beginning of year	46,181,974	44,546,519
Net assets at end of year	<u>\$ 44,587,852</u>	<u>\$ 46,181,974</u>

See accompanying notes.

St. Joseph Health Services of Rhode Island

Statements of Cash Flows

	Years Ended September 30	
	2006	2005
Operating activities		
Change in net assets	\$ (1,594,122)	\$ 1,635,455
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	4,769,874	4,458,385
Restricted contributions	(884,979)	(1,096,354)
Adjustment of minimum pension liability	(819,541)	819,541
Net unrealized gains on investments	(139,019)	(347,872)
Cumulative effect of change in accounting principle	2,732,346	—
Net assets assumed of H.E.L.P. Lead Safe Center	10,000	(236,082)
Changes in:		
Patient accounts receivable	(5,863,083)	3,548,438
Accounts payable	1,039,357	988,673
Estimated settlements to third-party payors	2,027,262	7,003,909
Other assets and liabilities	2,823,982	208,158
Net cash provided by operating activities	4,102,077	16,982,251
Investing activities		
Purchases of property and equipment	(6,119,373)	(4,691,697)
Net assets of H.E.L.P. Lead Safe Center assumed	(10,000)	236,082
Net purchases of investments	(5,227,540)	(7,188,986)
Increase in assets whose use is limited under bond indenture	(39,235)	(7,226)
Net cash used in investing activities	(11,396,148)	(11,651,827)
Financing activities		
Payments on capital lease obligations	(1,305,390)	(612,503)
Payments of long-term debt	(410,000)	(395,000)
Decrease in pledges receivable	124,759	139,837
Restricted contributions	884,979	1,096,354
Net cash (used in) provided by financing activities	(705,652)	228,688
(Decrease) increase in cash and cash equivalents	(7,999,723)	5,559,112
Cash and cash equivalents at beginning of year	15,594,747	10,035,635
Cash and cash equivalents at end of year	\$ 7,595,024	\$ 15,594,747
Non cash items:		
Equipment acquired through capital lease	\$ 4,892,566	\$ 1,396,664

See accompanying notes.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements

September 30, 2006

1. Organization

St. Joseph Health Services of Rhode Island (the Corporation) is an integrated, multilevel, multihospital, healthcare delivery system whose operating divisions serve Rhode Island and Southeastern New England. Core values, as defined by the Corporation's "mission statement," are consistent with the healing ministry of the Catholic Church.

Our Lady of Fatima Hospital in North Providence, a community-based medical center, offers a wide array of inpatient acute-care services, including medical and surgical services, a variety of subspecialties, an emergency department and comprehensive outpatient diagnostic services on-site and at satellite diagnostic centers. It features a regionally recognized critical care pavilion, an ambulatory care center, the state's largest endoscopy center, leading-edge laser technology, hyperbaric medical services and other modern diagnostic services, such as MRI, PET and CT scanner services. Its medical staff has a strong community-based primary care presence, in addition to an extensive selection of specialists.

The St. Joseph Hospital for Specialty Care in Providence offers a wide variety of sophisticated specialty services in addition to the nationally recognized Center for Health and Human Services, an integrated network of primary care and specialty clinics serving the economically disadvantaged and minority populations. Its Center for Psychiatric Services offers comprehensive inpatient adult and geriatric services, in addition to outpatient mental health services on-site and at off-site locations. St. Joseph also features the Southern New England Rehabilitation Center, a partnership with Rhode Island Hospital, offering tertiary-level medical rehabilitation for stroke, head and spinal cord trauma, and various other medical conditions. A skilled nursing facility is also operated at St. Joseph Hospital. Outpatient rehabilitation services are also available through a network of locations. The Hospital is also home to Corporate Care, an occupational health and safety service working with small and large businesses throughout Rhode Island.

In June 2002, the Corporation entered into a joint venture with MRI Centers of N.E. and opened the Northwest Rhode Island Imaging in Johnston, RI. The Corporation's investment in the venture is recognized within long-term investments on an equity basis.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

1. Organization (continued)

The Corporation also operates the St. Joseph School of Nursing and the St. Joseph Living Center. The latter is an assisted-living facility, and serves the emergent needs of the elderly population who desire residential living but require assistance with daily tasks. Respite care services are also provided.

The hospitals are licensed for 386 beds and are fully accredited by the Joint Commission on Accreditation of Hospitals. All operating units have received full licensure and are fully accredited by the numerous various regulating bodies. The hospitals are Medicare certified, participate in the Medicaid program and have contracts with Blue Cross and other health maintenance organization programs currently operating in the market.

On October 27, 2004 the Corporation assumed the activates and net assets of the H.E.L.P. Lead Safe Center (a not for profit Rhode Island Corporation). The merged organization was previously renting space within the Hospital and provided services to families within the community who are affected by lead poisoning. Under this agreement the Corporation assumed \$236,082 in unrestricted net assets. The Hospital will continue the activities of the former organization in conjunction with other lead safety initiatives. The effect of these operations on current year revenues and expenses was minimal.

2. Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Corporation considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, excluding amounts whose use is limited by board designation or other arrangements under trust agreements.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

Inventories

Inventories, consisting primarily of drugs and supplies, are stated at the lower of cost (first-in, first-out) or market.

Deferred Financing Costs

Deferred financing costs represent the costs associated with the issuance of the 1999 revenue bonds (see Note 8). These costs are being amortized proportionate to the bond maturities. Issuance costs are reported net of accumulated amortization of \$73,944 and \$62,599 at September 30, 2006 and 2005, respectively.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful life of each class of depreciable assets.

Equipment under capital lease is amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. This amortization is included in depreciation and amortization expense in the financial statements.

Investments

Investments in equity and debt securities are reported at fair value in the statements of financial position. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities. The Corporation accounts for investments in joint ventures and partnerships using the equity method, with the Corporation's share of the earnings (loss) on these ventures and partnerships included in other operating revenue. Distributions from joint ventures, expected to be received within the next year, are classified as current assets.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

In accordance with the Hospital's interpretation of the relevant state laws, realized and unrealized gains on endowment and specific purpose funds increase permanently and temporarily restricted net assets, respectively.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by or for the Corporation in perpetuity. Permanently restricted net assets consist primarily of the Corporation's beneficial interest in the Townsend Fund, the income from which is available to support services rendered by the Corporation.

Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors and others for services rendered, and includes estimated retroactive revenue adjustments due to future audits and reviews. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits and reviews.

The Healthcare Financing Administration (HCFA) approved a Medicaid disproportionate share plan for the State of Rhode Island. As a result, the Corporation received \$8,567,494 in 2006 and \$5,367,099 in 2005 from Medicaid, which is included in net patient service revenue in the statements of operations and changes in net assets.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Corporation are reported at fair value at the date the promise is received. Conditional promises to give are reported at fair value at the date the condition is satisfied. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions.

Excess of Revenue over Expenses

The statements of operations and changes in net assets include the excess of revenues over expenses. Changes in unrestricted net assets, which are excluded from the excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, changes in the minimum pension liability and contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, were to be used for the purposes of acquiring such assets).

Income Taxes

The Corporation is a not-for-profit hospital as described in section 501(c)(3) of the Internal Revenue Code, and is exempt from federal income taxes on related income pursuant to section 501(a) of the Code.

Asset Retirement Obligation

Effective September 30, 2006, the Corporation adopted the provisions of Financial Accounting Standards Board Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47"). Under FIN 47, the Corporation recorded an asset retirement obligation liability related to the estimated future costs of \$2,732,346 to remediate asbestos in certain buildings. Previously, such costs were accounted for as they were incurred. The cumulative effect of adopting this change in accounting principle as of September 30, 2006, represents a decrease in unrestricted net assets of \$2,732,346.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

New Accounting Standard

On September 29, 2006, the Financial Accounting Standards Board (FASB) issued statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R). The new standard applies to all plan sponsors who offer defined benefit post retirement benefit plans. Statement 158 requires an entity to recognize in its balance sheet an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's underfunded status, measure a defined benefit postretirement plan's assets and obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in changes in unrestricted net assets in the year in which the changes occur.

Statement 158 does not change the amount of net periodic benefit cost included in revenue in excess of expenses or address the various measurement issues associated with postretirement benefit plan accounting. The requirement to recognize the funded status of a defined benefit postretirement plan disclosure requirements are effective for the year ending September 30, 2007. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for the year ending September 30, 2009.

3. Charity Care and Community Services

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. During 2006 and 2005, the Corporation provided charity care of \$5,319,920 and \$6,206,399, respectively, measured using established rates.

In addition to the above-mentioned medical care rendered, the Corporation provides numerous other services to the community, free of charge. These services include such things as providing access to health care through interpreters, referral and transportation services, health care screening, community support groups, health educational programs, physician services and general community benefit services such as emergency preparedness programs. The cost of services provided to the community with revenues foregone were \$587,467 in 2006 and \$443,767 in 2005.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

3. Charity Care and Community Services (continued)

In addition to the cost of charity care and other community service programs, the Corporation provided \$9,760,662 and \$8,740,574 for uncollectible patient accounts during the years ended September 30, 2006 and 2005, respectively.

4. Investments

The composition of investments at September 30, 2006 and 2005 is set forth in the following table. Investments are stated at fair value.

	2006	2005
<i>Assets whose use is limited</i>		
Held by trustee under loan indenture agreements:		
Money market funds	\$ 2,653,436	\$ 2,614,201
	<u>\$ 2,653,436</u>	<u>\$ 2,614,201</u>
Beneficial interest in perpetual trust:		
Marketable equity securities	\$ 2,735,072	\$ 2,835,842
Bonds and notes	1,835,162	1,841,040
Mutual funds	1,098,810	892,396
Money market funds	157,314	158,232
	<u>\$ 5,826,358</u>	<u>\$ 5,727,510</u>
Held by trustee under workers' compensation program:		
Money market funds	\$ 844,121	\$ 340,292
	<u>\$ 844,121</u>	<u>\$ 340,292</u>
Endowment funds:		
Money market funds	\$ 86,094	\$ 72,434
U.S. Treasury obligations	813,505	800,830
	<u>\$ 899,599</u>	<u>\$ 873,264</u>

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

4. Investments (continued)

	2006	2005
<i>Other investments</i>		
Current assets:		
U.S. Treasury obligations	\$ 1,518,831	\$ 1,395,369
Certificates of deposit	807,423	2,789,164
Fixed income mutual funds	452,171	451,987
Money market funds	20,503,531	13,781,565
	<u>\$ 23,281,956</u>	<u>\$ 18,418,085</u>
Long-term investments:		
Investment in partnership	\$ 316,308	\$ 366,394
Investment in joint ventures	309,880	386,118
	<u>\$ 626,188</u>	<u>\$ 752,512</u>

The investment return is comprised of the following for the years ended September 30, 2006 and 2005:

	2006	2005
Included in other operating revenue:		
Interest income	\$ 1,248,589	\$ 625,697
Income from partnership	314,789	357,798
Loss from joint ventures	(79,000)	(78,765)
	<u>\$ 1,484,378</u>	<u>\$ 904,730</u>
Unrealized investment gains (losses) included in changes in net assets:		
Unrestricted	\$ (27,171)	\$ (38,845)
Temporarily restricted	63,681	56,113
Permanently restricted	102,509	330,604
	<u>139,019</u>	<u>\$ 347,872</u>

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

5. Property, Plant and Equipment

Property, plant and equipment, by major category, is as follows at September 30:

	2006	2005
Land and improvements	\$ 1,632,319	\$ 1,585,254
Buildings and improvements	60,032,945	58,800,587
Furniture and equipment	49,262,112	45,115,517
Construction in progress	6,766,660	717,622
	117,694,036	106,218,980
Less accumulated depreciation and amortization	72,036,949	66,831,500
Property, plant and equipment, net	\$ 45,657,087	\$ 39,387,480

6. Pledges Receivable

Pledges receivable and the allowances for uncollectible pledges at September 30 are as follows:

	2006	2005
Less than one year	\$ 102,504	\$ 138,301
One to five years	211,849	331,389
	314,353	469,690
Less unamortized discount	31,826	54,630
	282,527	415,060
Less allowance for uncollectibles	15,710	23,484
	\$ 266,817	\$ 391,576

A discount rate of 6.0% was used for the years ended September 30, 2006 and 2005.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

7. Line-of-Credit

The Corporation has an agreement with a bank providing for working capital borrowings up to \$4,000,000. These borrowings, which bear interest at the bank's prime rate, are unsecured. No amounts were outstanding under the line-of-credit agreement at September 30, 2006 and 2005.

8. Long-Term Debt and Capital Leases

Long-term debt consists of the following:

	September 30	
	2006	2005
Obligations under Rhode Island Higher Education Hospital Financing Revenue Bonds, Series 1999, net of original issue discount of \$794,014 and \$810,211 at September, 30 2006 and 2005, respectively; interest rates of 3.50% to 5.50%, due serially to October 1, 2029; interest is payable semiannually at April 1 and October 1 of each year; secured by a pledge of the Corporation's gross receipts and mortgage of certain property	\$ 19,975,986	\$ 20,369,789
Less current installments	(435,000)	(410,000)
Note payable	180,000	180,000
	<u>\$ 19,720,986</u>	<u>\$ 20,139,789</u>

During 1999, the Corporation issued Rhode Island Health and Educational Building Corporation Hospital Financing Revenue Bonds, Series 1999, in the amount of \$23,145,000. These proceeds were used to refinance all of the Corporation's then-outstanding long-term debt and capital leases of \$9,025,000, and provide \$14,120,000 to be used for capital projects.

The required annual principal payments of long-term debt in the years ending September 30, 2007 through 2011 are \$435,000, \$460,000, \$480,000, \$510,000, and \$535,000, respectively, with the remaining balance of long-term debt outstanding of \$18,350,000, due serially through October 1, 2029.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

8. Long-Term Debt and Capital Leases (continued)

The obligations under the Rhode Island Higher Education Hospital Financing Revenue Bonds have specific covenants with which the Corporation must comply. At September 30, 2006 and 2005, the Corporation was in compliance with these financial covenants. In addition, the Corporation is required to maintain certain deposits with a trustee. At September 30, 2006 and 2005, such deposits, which are included in assets whose use is limited, are summarized as follows:

	<u>2006</u>	<u>2005</u>
Debt service fund	\$ 1,052,345	\$ 1,037,642
Debt service reserve fund	1,601,091	1,576,559
	<u>\$ 2,653,436</u>	<u>\$ 2,614,201</u>

Cash paid for interest during 2006 and 2005 amounted to \$1,473,662 and \$1,261,990, respectively.

In 2002, the Corporation entered into a loan agreement with SJHS Imaging Center, Inc. in the amount of \$180,000. The unsecured loan was to pay for the Corporation's share of build-out costs associated with opening SJHS Imaging Center, Inc. The five-year loan payable carries an interest rate of 8.625%, payable in "interest only" installments until June 2008, when a final payment in the amount of \$107,356 is due.

Capital Leases

The Hospital classifies certain noncancelable leases as capital leases and includes the property under lease in its property and equipment along with the related accumulated depreciation.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

8. Long-Term Debt and Capital Leases (continued)

Future minimum lease payments due under capital lease arrangements at September 30, 2006 are as follows:

2007	\$ 1,990,225
2008	1,745,839
2009	1,669,336
2010	1,618,511
2011	1,288,580
Total minimum lease payments	8,312,491
Less amount representing interest	2,401,138
Present value of net minimum lease payments	<u>\$ 5,911,353</u>

9. Operating Leases

The Corporation has entered into noncancelable operating lease agreements with several vendors for the lease of certain computer, radiology and other equipment. Total rental expense amounted to \$3,132,326 and \$2,797,990 for the years ended September 30, 2006 and 2005, respectively. Future minimum payments as of September 30, 2006, under noncancelable operating leases, are as follows:

2007	\$ 1,525,649
2008	1,290,880
2009	833,852
2010	335,968
2011	212,892
	<u>\$ 4,199,241</u>

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

10. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30, 2006 and 2005:

	2006	2005
Capital projects	\$ 1,924,291	\$ 1,536,735
Operating activities	280,164	281,098
Educational	71,569	53,360
	<u>\$ 2,276,024</u>	<u>\$ 1,871,193</u>

Permanently restricted net assets at September 30, 2006 and 2005 are restricted to:

	2006	2005
Investments to be held in perpetuity, the income from which is available to support health care services	\$ 6,772,532	\$ 6,540,022
Investments to be held in perpetuity, the income from which is available to support education	80,929	80,828
	<u>\$ 6,853,461</u>	<u>\$ 6,620,850</u>

11. Pension Plan

The Corporation's defined benefit pension plan covers substantially all of the Corporation's employees. Plan participants' benefits are computed as a percentage of final average earnings (five highest consecutive rates of annual earnings over the last ten years of employment) less a percentage of Social Security benefits, proportionately reduced for services less than thirty years. Although the plan is not subject to ERISA, the Corporation's policy is to fund at least the minimum amount required under the ERISA guidelines.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

11. Pension Plan (continued)

The components of the net periodic benefit cost for each of the plans for the years ended September 30, 2006 and 2005 are as follows:

	2006	2005
Service cost	\$ 3,490,374	\$ 3,311,926
Interest cost	6,783,246	6,334,600
Expected return on plan assets	(8,143,838)	(8,416,271)
Prior service cost amortization	562,761	562,761
Amortization of actuarial loss (gain)	813,457	(8)
Net periodic cost	<u>\$ 3,506,000</u>	<u>\$ 1,793,008</u>

The weighted-average assumptions used to determine net periodic benefit cost as of September 30, 2006 and 2005, are as follows:

	2006	2005
Discount rates	5.25%	6.25%
Rates of increase in future compensation levels	3.50%	3.50%
Expected long-term rate of return on plan assets	8.75%	8.75%

A reconciliation of the changes in the Corporation's Retirement Plan projected benefit obligations and the fair value of assets for the years ended September 30, 2006 and 2005, and a statement of funded status of the plans as of September 30 for both years, follows:

	2006	2005
Changes in benefit obligations		
Projected benefit obligations at beginning of year	\$ 124,384,703	\$ 102,472,971
Service cost	3,490,374	3,311,926
Interest cost	6,783,246	6,334,600
Benefits paid	(3,481,436)	(3,410,100)
Experience (gain) loss	(13,164,593)	15,675,306
Projected benefit obligation at end of year	<u>\$ 118,012,294</u>	<u>\$ 124,384,703</u>

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

11. Pension Plan (continued)

	2006	2005
Changes in plan assets		
Fair value of plan assets at beginning of year	\$ 94,837,161	\$ 89,475,173
Actual return on plan assets	10,967,754	8,772,088
Benefits paid	(3,481,436)	(3,410,100)
Fair value of plan assets at end of year	<u>\$ 102,323,479</u>	<u>\$ 94,837,161</u>
Funded status		
Funded status of the plan	\$ (15,688,815)	\$ (29,547,542)
Unrecognized net loss	8,076,065	24,878,031
Unrecognized prior service costs	4,517,400	5,080,161
Prepaid pension costs	(3,095,350)	410,650
Additional minimum liability	–	(5,899,702)
Net pension liability	<u>\$ (3,095,350)</u>	<u>\$ (5,489,052)</u>

The weighted-average assumptions used to determine the pension benefit obligation at September 30, 2006 and 2005 are as follows:

	2006	2005
Discount rates	6.25%	5.25%
Rates of increase in future compensation levels	3.50%	3.50%
Expected long-term rate of return on plan assets	8.75%	8.75%
Measurement date	June 30, 2006	June 30, 2005

The accumulated benefit obligation as of September 30, 2006 and 2005 was \$93,420,272 and \$100,326,213, respectively. Under the requirements of Statement of Financial Accounting Standards No. 87, *Employers Accounting for Pensions*, an additional pension liability of \$5,899,702 representing the excess of accumulated benefits over plan assets less prepaid pension costs, was recognized at September 30, 2005. In connection with this liability, the Corporation recorded a charge to unrestricted net assets of \$819,541 and an intangible asset of \$5,080,161 corresponding to the unrecognized prior service costs. There was no minimum pension liability required at September 30, 2006.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

11. Pension Plan (continued)

Plan Assets

The primary investment objective of the Corporation's defined benefit pension plan is to provide pension benefits for its members and their beneficiaries by ensuring a sufficient pool of assets to meet the Plan's current and future benefit obligations. These funds are managed as permanent funds with disciplined longer-term investment objectives and strategies designed to meet cash flow requirements of the plan. Although the plan is not subject to ERISA, funds are managed in accordance with these and all other regulatory requirements.

Management of the assets is designed to maximize total return while preserving the capital values of the fund, protecting the fund from inflation, and provide liquidity as needed for plan benefits. The objective is to provide a rate of return that meets inflation, plus 5.0%, over a long-term horizon.

The plan aims to diversify its holdings among sectors, industries and companies.

A periodic review is performed of the pension plan's investment in various asset classes. The current asset allocation target is 70% equities and 30% fixed income.

The Corporation's pension plan asset allocations at September 30, 2006 and 2005, by asset category are as follows:

	Plan Assets at September 30	
	2006	2005
Marketable equity securities	78%	73%
U.S. government obligations and corporate bonds	20	25
Other	2	2
Total	100%	100%

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

11. Pension Plan (continued)

Contributions

The Corporation is not required to make a contribution to its pension plan in 2006.

Estimated Future Benefit Payments

Benefit payments, which reflect expected future service, are expected to be as follows:

<u>Fiscal Year</u>	<u>Pension Benefits</u>
2007	\$ 3,444,384
2008	3,664,162
2009	3,968,151
2010	4,329,131
2011	4,739,570
Years 2012–2015	31,877,896

12. Professional Liability Insurance

The Corporation insures its professional liability risks pertaining to medical malpractice on a claims-made basis. From October 1, 1998 to October 1, 2001, the Corporation was insured for professional liability loss contingencies by an insurance company that, on August 16, 2001, was placed into rehabilitation by the insurance commissioner of the Commonwealth of Pennsylvania. The Corporation has established reserves to cover professional liability exposure that may not be covered by current or prior insurance policies, including a reserve for estimated claims incurred but not reported to the insurance company.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

13. Workers' Compensation

As of December 1, 1999, the Corporation obtained commercial insurance for its workers' compensation liability. The Corporation maintains a stop-loss insurance policy for workers' compensation claims made prior to December 1, 1999. Accordingly, amounts up to the stop-loss limit are self-insured by the Corporation. The Corporation has accrued its estimate of the ultimate potential workers' compensation loss based upon an actuarial study, which developed the estimated loss based upon actual paid claims. The estimated ultimate losses were discounted using a rate of five percent. In order to provide for the ultimate payment of the estimated loss, the Corporation has deposited amounts into a trust that are sufficient to fund the estimated liability. In addition, the Corporation has posted a \$650,000 surety bond.

14. Third-Party Payment Arrangements

The Corporation maintains agreements with the Social Security Administration under the Medicare program, the State of Rhode Island under the Medicaid Program, Blue Cross of Rhode Island and United Health Plans of New England, among others, that govern payment to the Corporation for services rendered to patients covered by these programs.

Medicare utilizes a prospective payment system for inpatient medical surgical, rehabilitation and transitional care services where payment is based on the classification of a case into a diagnosis-related group (DRG). Inpatient psychiatric nonacute services related to Medicare beneficiaries are paid based on cost up to a specified limit. Medicare outpatient services are paid on a prospective payment system based upon ambulatory payment classifications (APC). The method of payment for Rhode Island Blue Cross is a per diem system for inpatient services and a negotiated fee schedule for outpatient services.

The majority of Rhode Island Medicaid patients are reimbursed under the RiteCare program funded by the State of Rhode Island. The RiteCare program is administered by area insurance companies and HMOs. Most of the Corporation's revenue from the RiteCare program is through United Health Plans of New England and Neighborhood Health Plan and payments are based upon per diems for inpatients and fee schedules for outpatient services. Medicaid patients not included in the RiteCare program are reimbursed based on budgeted costs under a prospective cost contract and reimbursement is adjusted based upon actual patient volume.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

14. Third-Party Payment Arrangements (continued)

The Corporation has entered into contracts with other insurance companies and health maintenance organizations whereby they are generally paid on a per-diem basis for inpatients and fee schedules for outpatient services.

Cost reports filed annually with third-party payors are subject to audit prior to final settlement. The Corporation has settled with Medicaid through 2001, and final settled with Medicare through 2002.

Revenues from the Medicare and Medicaid programs accounted for approximately 33% and 9%, respectively, of the Corporation's net patient revenue for the year ended September 30, 2006. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. The Corporation believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation. There is at least a reasonable possibility that recorded amounts could change by a material amount in the near term. Differences between amounts previously estimated and amounts subsequently determined to be recoverable or payable are included in net patient service revenues in the year that such amounts become known. Such differences (decreased) increased revenues by approximately \$(758,000) and \$992,000 for the years ended September 30, 2006 and 2005, respectively.

During fiscal 2006 and 2005, hospitals in Rhode Island were subject to a state license fee, based on a percentage of gross charges, which is reflected as an expense in the statement of operations. The license fee was \$4,919,485 and \$4,076,878 for the years ended September 30, 2006 and 2005, respectively.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

15. Concentrations of Credit Risk

The Corporation grants credit to patients, substantially all of whom are local residents. The Corporation generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross, health maintenance organizations and commercial insurance policies).

The mix of receivables from patients and third-party payors at September 30, 2006 and 2005:

	2006	2005
Medicare	38%	29
Blue Cross	9	10
Medicaid	7	8
Health maintenance organizations	30	35
Private insurance	3	4
Workers' compensation	1	1
Self-pay	12	13
	100%	100%